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**LIABILITY OF DEFENSE CONTRACTORS  
FOR HAZARDOUS WASTE CLEANUP COSTS**

**A Thesis**

**Presented to**

**The Judge Advocate General's School, United States Army**

The opinions and conclusions expressed herein are those of the author and do not necessarily represent the views of either The Judge Advocate General's School, The United States Army, or any other governmental agency.

**by Captain Margaret O. Steinbeck, JAGC**

**United States Army**

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**LIABILITY OF DEFENSE CONTRACTORS  
FOR HAZARDOUS WASTE CLEANUP COSTS**

by Captain Margaret O. Steinbeck, JAGC

**ABSTRACT:** This thesis examines the liability of defense contractors to pay for hazardous waste cleanup costs. While CERCLA imposes strict, joint, and several liability, the contractor and DoD may agree to reallocate CERCLA liability under the terms of the contract. This raises questions concerning who should pay for hazardous waste cleanup: the contractor, the contractor's insurers, or DoD? This thesis concludes that DoD should pay contractor's hazardous waste cleanup costs in certain limited circumstances, pursuant to the authority to indemnify contractors under Public Law 85-804 and 10 U.S.C. section 2354.

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## LIABILITY OF DEFENSE CONTRACTORS

### FOR HAZARDOUS WASTE CLEANUP COSTS

I am directing the Attorney General and the Administrator of the Environmental Protection Agency to use every tool at their disposal to speed and toughen the enforcement of our laws against toxic waste dumpers. I want faster cleanups and tougher enforcement of penalties against polluters. [Address by President Bush to joint session of Congress, 9 February 1989.]<sup>1</sup>

#### I. INTRODUCTION

The 1980 Comprehensive Environmental Response, Compensation and Liability Act<sup>2</sup> (CERCLA or Superfund) was enacted to address the threat posed by the 30-50,000 improperly managed hazardous waste sites in this country and to provide emergency response to hazardous waste spills.<sup>3</sup> The Act requires responsible parties to clean up hazardous waste sites and other dangerous chemical releases or to reimburse the government for the cost of cleanup.<sup>4</sup> Hazardous waste cleanup liability under CERCLA extends to past and present owners, transporters, and generators of

hazardous waste.<sup>5</sup> CERCLA imposes strict, joint and several liability on these Potentially Responsible Parties (PRPs).<sup>6</sup>

The Superfund Amendments and Reauthorization Act (SARA) provides that CERCLA applies to facilities owned or operated by a department, agency, or instrumentality of the United States.<sup>7</sup> The Department of Defense (DoD) is therefore a PRP for cleanup costs at DoD facilities, as either an owner, transporter, or generator of hazardous waste.<sup>8</sup> Currently, DoD has identified more than 5,000 sites needing hazardous waste cleanup.<sup>9</sup> DoD plans to spend about \$500 million on hazardous waste cleanup in the next fiscal.<sup>10</sup>

In many situations, DoD contractors share DoD's CERCLA liability for hazardous waste cleanup costs at DoD facilities. While DoD may be liable as an owner, the contractor is often liable as a transporter or generator of hazardous waste.<sup>11</sup> When CERCLA does not impose liability on DoD (for example, for hazardous waste cleanup at contractor-owned, contractor-operated facilities), DoD may share liability for hazardous waste cleanup costs with the contractor under the terms of the contract.

This thesis examines the relationship between DoD and DoD contractors concerning hazardous waste cleanup costs<sup>12</sup> where CERCLA imposes some contractor liability. The thesis first discusses DoD and contractor responsibility for hazardous waste cleanup costs under the provisions of CERCLA. Applicable federal and DoD contracting regulations will then be examined to

determine how these contract provisions modify the responsibility of DoD and DoD contractors to pay for hazardous waste cleanup. First, federal procurement regulations concerning allowable costs in cost-reimbursement contracts and increased prices in fixed-price contracts will be discussed. Next, the discussion will explore the possibility of obtaining liability insurance to cover cleanup costs. Finally, the availability and effect of government indemnification of contractors for hazardous waste cleanup costs will be discussed. In conclusion, this thesis suggests a structure for future government contracts to fairly and efficiently allocate the costs of hazardous waste cleanup between DoD and DoD contractors, to insure the availability of essential goods and services to DoD.

## **II. CERCLA LIABILITY FOR HAZARDOUS WASTE CLEANUP COSTS**

### **A. POTENTIALLY RESPONSIBLE PARTIES**

CERCLA Section 107(a) provides that four classes of persons may be liable for costs incurred in response to the release and cleanup of hazardous substances ("response costs") and damages to natural resources:

- 1) The owner and operator of a vessel or facility (the current "owner");



2) Any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of (past "owners");

3) Any person who by contract, agreement, or otherwise arranged for disposal or treatment, or for transport for disposal or treatment of hazardous substances ("generators"); and

4) Any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities ("transporters").<sup>13</sup>

Current owners are liable for hazardous waste cleanup costs even if they did not own the site at the time of disposal or cause the release of the hazardous material.<sup>14</sup> Past owners are liable if the hazardous waste was disposed<sup>15</sup> of at the site at the time of their ownership.<sup>16</sup>

Under Section 107(a)(1) of CERCLA, DoD is potentially liable as an "owner" for hazardous waste cleanup costs at any government owned facility.<sup>17</sup> This includes facilities where the government operates all of the activity (government owned/government operated, or GOGO), facilities operated at least in part by private contractors (government owned/contractor operated, or GOCO), and facilities owned by the government but leased to private parties.<sup>18</sup>

Contractors and other private parties operating on government owned facilities are also potentially liable for hazardous waste cleanup costs under CERCLA section 107(a)(3). This section imposes liability on anyone who arranges for disposal of hazardous waste. To be liable under this section, there is no requirement that the person own or possess the hazardous waste or the facility from which it is disposed.<sup>19</sup> Further, section 107(a)(3) "generators" are liable for hazardous waste cleanup costs even if they did not generate the hazardous substance.<sup>20</sup> The critical question is whether the PRP made arrangements for disposal of the hazardous waste.<sup>21</sup>

Section 107(a)(3) liability includes past generators of hazardous waste who merely arranged for disposal or transportation of hazardous material to a facility from which a present release is threatened or occurring.<sup>22</sup> A person "cannot escape liability by 'contracting away' [his] responsibility or by alleging that the incident was caused by the act or omission of a third party."<sup>23</sup> In other words, it is not necessary that the generator have anything to do with the release that necessitates clean up.<sup>24</sup> If the person arranged for disposal, he is a PRP.

Contractors and other parties operating on government owned facilities will be liable for CERCLA cleanup costs if they made arrangements to dispose of the hazardous waste that needs to be cleaned up. These parties will not be able to escape CERCLA liability by

arguing that they did not own the waste or cause the release. They may also be liable under CERCLA section 107(a)(4) if they transport hazardous waste for disposal.

At contractor-owned, contractor-operated (COCO) facilities, the contractor is potentially liable for CERCLA cleanup costs as either an "owner", "generator" or "transporter". This liability is not shared with the government under CERCLA, unless the government arranges for disposal of the hazardous waste.<sup>25</sup>

#### B. RESPONSE COST LIABILITY

Under the provisions of CERCLA, DoD and DoD contractors will often be PRPs for costs associated with the clean up of hazardous waste. CERCLA section 107(a) provides that PRPs are liable for "a release, or threatened release [of a hazardous substance] which causes the occurrence of response costs."<sup>26</sup> "Release" is defined in section 101(22) as "any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment."<sup>27</sup> A "release" includes, for example, leaking tanks and pipelines, seepage from earlier spills, and leaking drums of hazardous materials.<sup>28</sup> A "threatened release" may include corroding or deteriorating tanks, the owner's lack of expertise in handling hazardous waste, and even the failure to license the facility.<sup>29</sup>

When there is a release of a hazardous substance<sup>30</sup>, PRPs are liable for:

(1) All costs of removal or remedial action incurred by the United States Government, a State, or an Indian tribe not inconsistent with the national contingency plan;<sup>31</sup>

(2) Any other necessary costs of response incurred by any other person consistent with the national contingency plan;

(3) Damages for injury to, destruction of, or loss of natural resources; and

(4) The costs of any health assessment or health effects study carried out pursuant to CERCLA.<sup>32</sup>

Response costs<sup>33</sup> are incurred in two types of cleanup actions: (1) remedial action,<sup>34</sup> or long term or permanent containment or disposal programs; and (2) removal actions,<sup>35</sup> or short term cleanup arrangements. For purposes of this thesis, the term "cleanup costs" refers to liabilities generated by both remedial and removal actions.<sup>36</sup>

The United States Environmental Protection Agency (EPA) may seek recovery of response costs from DoD or DoD contractors for hazardous waste cleanup at federal facilities. EPA's enforcement process for Executive

Branch agencies is purely administrative, however, and does not provide for civil judicial action or assessment of civil penalties.<sup>37</sup> Significantly, this limitation does not extend to government contractors. EPA has stated that it "will pursue the full range of its enforcement authorities against private operators of Federal facilities (e.g., GOCOs) where appropriate and also take action against Federal agencies at GOCO facilities in certain circumstances."<sup>38</sup>

States and private parties may also seek recovery of hazardous waste cleanup costs from DoD or DoD contractors. Under CERCLA section 107, states may seek to recover removal or remedial action costs "not inconsistent with the national contingency plan."<sup>39</sup> Private parties may seek to recover costs which are "necessary" and "consistent with the national contingency plan."<sup>40</sup> State and private party recovery actions may include civil suits against both DoD<sup>41</sup> and DoD contractors.

### C. STRICT LIABILITY

CERCLA section 101(32) provides that the standard of liability under the Act will be the standard of liability imposed by section 311 of the Clean Water Act of 1977.<sup>42</sup> Based on the legislative history of CERCLA and the fact that section 311 has consistently been construed as a strict liability provision, courts have held that responsible parties are strictly liable under CERCLA.<sup>43</sup> In other words, claims that defendants

exercised due care or were not negligent cannot be used to avoid liability under the act.<sup>44</sup>

Although the standard of liability is strict liability, CERCLA does not impose absolute liability.<sup>45</sup> There are four enumerated defenses to liability under CERCLA. To avoid liability, a PRP must show that the release and the damages were caused by: (1) an act of God; (2) an act of war; (3) an act or omission of a third party, other than an employee or agent of the defendant, or one who has a contractual relationship with the defendant, provided the defendant exercised due care with respect to the hazardous substance concerned and that he took precautions against the foreseeable acts or omissions of the third party, and the resulting consequences; or (4) a combination of the above.<sup>46</sup>

These defenses will rarely be available to either DoD or DoD contractors to avoid liability for hazardous waste cleanup costs. Since DoD and DoD contractors generate hazardous waste in the course of routine operations, the release and resulting damages will rarely be caused by an act of God or an act of war. Further, the release and resulting damages will usually be the result of some act or omission of DoD's employee or agent, or the contractor's employee, agent or subcontractor. Therefore, neither DoD or the contractor will be able to claim the third party defense. DoD and DoD contractors will likely be strictly liable under CERCLA for hazardous waste

cleanup costs whenever they can be characterized as an owner, generator, or transporter.<sup>47</sup>

#### D. JOINT AND SEVERAL LIABILITY

CERCLA does not delineate any degree of liability in cases involving more than one PRP. After examining the legislative history and policies of CERCLA, the first courts to consider the issue determined that joint and several liability should be imposed in appropriate multiparty cases.<sup>48</sup>

In developing a uniform federal common law in this area, the courts adopted the rule of the Restatement (Second) of Torts, that "when two or more persons acting independently cause a distinct or single harm for which there is a reasonable basis for division according to the contribution of each, each is subject to liability only for the portion of the total harm that he caused."<sup>49</sup> The burden of proof as to the apportionment in such cases is upon the defendant who seeks to limit his liability.<sup>50</sup> If the harm is indivisible, or there is no reasonable basis for division, each party is subject to liability for the entire harm.<sup>51</sup>

The issue, then, is whether the harm is "divisible" or "indivisible".<sup>52</sup> In many CERCLA actions there will be numerous hazardous waste generators or transporters who have disposed of wastes at a particular site. A rule of joint and several liability obviously assists in the recovery of cleanup costs from

multiparty defendants in these cases, where the harm will likely be "indivisible."

Joint and several liability is permitted, but it may not be required in every case where harm is indivisible.<sup>53</sup> The legislative history of the Act indicates concern that a joint and several liability standard could unfairly "impose financial responsibility for massive costs and damages...on persons who contributed only minimally (if at all) to a release or injury."<sup>54</sup> Recognizing this concern, courts may still apportion damages on a case by case basis, even if the defendant cannot prove his contribution to the injury.<sup>55</sup> To determine apportionment, courts focus on the following criteria:

- (i) the ability of the parties to demonstrate that their contribution to a discharge release or disposal of a hazardous waste can be distinguished;
- (ii) the amount of the hazardous waste involved;
- (iii) the degree of toxicity of the hazardous waste involved;
- (iv) the degree of involvement by the parties in the generation, transportation, treatment, storage, or disposal of the hazardous waste;
- (v) the degree of care exercised by the parties with respect to the hazardous waste concerned, taking into account the



characteristics of such hazardous waste; and  
(vi) the degree of cooperation by the  
parties with Federal, State, or local  
officials to prevent any harm to the public  
health or the environment.<sup>56</sup>

#### E. THE RIGHT OF CONTRIBUTION

A person held jointly and severally liable under CERCLA may seek contribution from other potentially responsible parties. CERCLA section 113(f) was added by SARA to create an express right of contribution between liable PRPs.<sup>57</sup> Courts had already recognized a common law right of contribution under CERCLA.<sup>58</sup> The new statutory provision does validate this practice, however, and it gives wide discretion in contribution issues by directing that response costs may be allocated according to such equitable factors as the court determines are appropriate.<sup>59</sup>

Persons who have resolved their liability to the United States or a State in an administratively or judicially approved settlement are not liable for claims for contribution regarding matters addressed in the settlement.<sup>60</sup> The settling party may, however, seek contribution from responsible parties who are not party to the settlement.<sup>61</sup>

### III. CERCLA LIABILITY: DoD v. DEFENSE CONTRACTORS

CERCLA specifically provides that no indemnification, hold harmless, or similar agreement shall be effective to negate liability in CERCLA cost recovery actions.<sup>82</sup> Agreements to insure, hold harmless, or indemnify another party for CERCLA liability are not prohibited, however.<sup>83</sup> In other words, "CERCLA expressly reserves the right of private parties to contractually transfer to or release another from the financial responsibility arising out of CERCLA liability."<sup>84</sup> Of course, PRPs remain accountable for any cleanup costs incurred by the government, regardless of conveyance or transfer of liability between private parties.<sup>85</sup> PRPs who have paid cleanup costs, in spite of having contractually transferred CERCLA liability to another party, will have a contractual claim for reimbursement from the other party. They also may have a claim for reimbursement based on the CERCLA contribution provisions.<sup>86</sup>

Since CERCLA allows parties to enter into agreements where they are indemnified or held harmless by another party, either the government or the contractor may agree to assume the other party's hazardous waste cleanup costs. This may occur regardless of whether the party assuming liability has any liability under the provisions of CERCLA. In other words, the government could agree to pay hazardous waste cleanup costs at a COCO facility, where it is unlikely the government would have any liability under

the provisions of CERCLA. The government could also agree to pay all hazardous waste cleanup costs at a GOCO facility, even though the contractor would likely share liability under the provisions of CERCLA.

The possibility of allocating the amount of contribution between parties under the terms of the contract raises the question whether the government should agree to pay hazardous waste cleanup costs incurred by government contractors, which is the focus of this thesis. If so, how can this best be accomplished under the terms of the contract? The answers to these questions may depend on the type of contract (cost-reimbursement or fixed-price) and whether CERCLA imposes liability on the government. Accordingly, these issues will be discussed below in the context of four scenarios: (1) a cost-reimbursement contract in a factual setting where the government shares liability with the contractor under the provisions of CERCLA; (2) a cost-reimbursement contract where the government does not share liability with the contractor under the provisions of CERCLA; (3) a fixed-price contract where the government shares liability with the contractor under the provisions of CERCLA; and (4) a fixed-price contract where the government has no CERCLA liability and has not expressly assumed liability for cleanup operations under the terms of the contract.

#### IV. SHARED LIABILITY AND THE TERMS OF THE CONTRACT

There are several ways a contractor may try to pass hazardous waste cleanup costs to the government under the terms of the contract. In a cost-reimbursement contract, the contractor may seek reimbursement from the government for hazardous waste cleanup costs, arguing that these are "allowable costs." In a fixed-price contract, the contractor may simply raise his prices at the time of the bid to cover his actual or potential hazardous waste cleanup costs. Additionally, contractors may seek government indemnification provisions for hazardous waste cleanup costs in both cost-reimbursement and fixed-price contracts.

An alternative to either the contractor or the government paying for hazardous waste cleanup costs is to pass these costs on to an insurer. In fact, many government contracts require the contractor to furnish proof of comprehensive general liability insurance, which may cover some hazardous waste cleanup costs. Alternatively, the contractor may obtain "Environmental Impairment Liability" (EIL) insurance that would pay for some hazardous waste cleanup costs. The government may or may not agree to pay the contractor's insurance premiums in cost-reimbursement contracts.

These alternatives are addressed separately in the discussion below, although in some cases they may be used in combination to achieve the desired allocation of CERCLA response cost liability.

## A. ALLOWABLE COSTS IN COST-REIMBURSEMENT CONTRACTS

### 1. The General Rule: Reasonable, Allocable, and Not Specifically Prohibited

Cost-reimbursement type contracts have a number of unique characteristics. A cost-reimbursement contract may only be used if "[t]he contractor's accounting system is adequate for determining costs applicable to the contract, [and] [a]ppropriate government surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used."<sup>67</sup> Additionally, a determination and finding must be executed showing that a cost-reimbursement contract is likely to be less costly than any other type, or it is impractical to obtain supplies or services of the kind or quality required without the use of a cost-reimbursement contract.<sup>68</sup>

In a cost-reimbursement contract, the contractor is paid for "allowable costs," but is not paid for "unallowable costs."<sup>69</sup> "These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at his own risk) without the approval of the contracting officer."<sup>70</sup> Thus, even if a cost is allowable, the limitations of cost clause may prevent the contractor from getting reimbursed.

Hazardous waste cleanup costs are not specifically addressed as an "allowable cost" in either the Federal

Acquisition Regulation (FAR) or the Defense Federal Acquisition Regulation Supplement (DFARS). I have found no reported cases directly addressing environmental cleanup costs in government contracts. The general rule, however, is that allowable costs must be "reasonable," "allocable," and not specifically prohibited by regulation or the terms of the contract."<sup>71</sup>

The FAR provides that "[a] cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business."<sup>72</sup> The regulation further provides that what is reasonable will depend on a variety of considerations and circumstances, including--

- (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;

- (2) Generally accepted sound business practices, arm's length bargaining, and Federal and State laws and regulations;

- (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and

(4) Any significant deviations from the contractor's established practices.<sup>73</sup>

The regulation also provides that "[a] cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship."<sup>74</sup> A cost is allocable to the government, subject to the foregoing, if it--

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.<sup>75</sup>

A few specific regulatory provisions concerning allowable costs are relevant to the issue of which, if any, hazardous waste cleanup costs are allowable:

(1) Contingencies. Costs for contingencies are generally unallowable. Contingencies include possible future events or conditions arising from presently

known or unknown causes, the outcome of which is indeterminable at the present time.<sup>76</sup>

(2) Fines and penalties. Costs of fines and penalties incurred as a result of the contractor's violation of law or regulation are unallowable unless they were incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.<sup>77</sup>

(3) Insurance and indemnification. Costs of insurance maintained by the contractor as required by the contract are allowable. Actual losses are unallowable, except for the nominal deductible provisions of purchased insurance and minor losses such as spoilage.<sup>78</sup>

(4) Maintenance and repair costs. Normal maintenance and repair costs are allowable if they do not add to the permanent value of the property nor appreciably prolong its intended life. Expenditures for plant and equipment which should be capitalized and subject to depreciation are allowable only on a depreciation basis.<sup>79</sup>

(5) Manufacturing and production engineering costs. Costs for developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques for producing products and services are allowable.<sup>80</sup>



## 2. Are Hazardous Waste Cleanup Costs Allowable?

For purposes of this discussion, the types of costs the contractor may try to recover from the government on a cost-reimbursement contract fall into two broad categories:<sup>81</sup> (1) costs to avoid future pollution;<sup>82</sup> and (2) costs incurred to cleanup pollution. Cleanup costs may include repair or replacement of leaking containers, storage, confinement, neutralization of contaminants, perimeter protection, providing alternative water supplies, and even relocation of threatened residents, businesses, and community facilities.<sup>83</sup> These cleanup costs may result from willful noncompliance with laws, regulations, permits and orders, or simple negligence, or may even result from innocent, non-negligent pollution.<sup>84</sup>

As long as they are allocable to the contract, reasonable costs incurred to avoid pollution should be allowable. This policy is consistent with the specific federal regulations providing that costs for maintenance and repair, and developing new or improved materials, systems, methods and equipment are generally allowable.<sup>85</sup> Since contractors are required to comply with environmental laws concerning pollution control and clean air and water,<sup>86</sup> the costs of compliance should be considered "ordinary and necessary for the conduct of the contractor's business or the contract performance."<sup>87</sup>

When the government will share any CERCLA liability with the contractor, reimbursing the contractor for pollution avoidance costs may ultimately save the government money by avoiding CERCLA cleanup costs. Pollution avoidance is usually much less expensive than the cost of cleaning up hazardous waste contamination.

Cleanup costs resulting from non-compliance with laws and regulations should not be allowable. Denying the contractor reimbursement for these costs is consistent with regulatory provisions specifying that fines and penalties are normally unallowable.<sup>88</sup> These costs are not reasonable since they cannot be considered to be consistent with "[g]enerally accepted sound business practices."<sup>89</sup> Although the government may still face CERCLA liability as a result of contractor non-compliance with environmental protection laws, government liability will not increase as a consequence of denying these costs. Denying these costs will also provide incentives for contractor compliance with environmental laws, which will protect the environment and save the government money.

The contractor may also request reimbursement for cleanup costs which were not incurred as a result of any negligence on the part of the contractor. This could arise, for example, if the hazardous nature of the waste was unknown at the time the contract was negotiated and performed. Under the strict liability standards of CERCLA, the contractor would be liable for cleanup costs even though its disposal practices were

consistent with industry standards at the time. If the contractor seeks reimbursement from the government, are these allowable costs?

The answer is not clear, but cleanup costs incurred due to innocent non-negligent pollution should be allowable.<sup>90</sup> Such costs are reasonable since they are the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance.<sup>91</sup> These costs are also consistent with the contractor's responsibilities to the government and the public at large under CERCLA.<sup>92</sup>

A more difficult policy question arises when the contractor seeks reimbursement for cleanup costs incurred as a result of contractor negligence. Paying contractors for these costs may encourage the contractor to be negligent. On the other hand, such costs may be considered "ordinary and necessary for the conduct of the contractor's business".<sup>93</sup> Most contractors expect to suffer some losses due to the negligence of the contractor, or the contractor's agents, servants or employees. Whether or not such costs should be allowable will depend heavily on the facts.<sup>94</sup> Allowability should turn on the degree of contractor culpability.<sup>95</sup>

The FAR encourages advance agreements concerning the allowability of costs where reasonableness and allocability may be difficult to determine.<sup>96</sup> Of course, such agreements may not treat costs inconsistently with the regulation.<sup>97</sup> Advance

agreements should be used whenever possible to resolve the allowability of anticipated pollution avoidance and hazardous waste cleanup costs.

Even if a cost has been incurred unreasonably, the contractor may try to recover his costs under another provision in the contract, for example, an indemnification clause, or the "Insurance-Liability to Third Persons" clause.<sup>98</sup> In cases where the government shares liability with the contractor under the provisions of CERCLA, the contractor may also have a CERCLA claim for contribution from the government.<sup>99</sup>

### **3. Impact of Allowing/Disallowing Hazardous Waste Cleanup Costs in Cost-Reimbursement Contracts**

If the government does not reimburse the contractor for hazardous waste cleanup costs as allowable costs in a cost-reimbursement contract, and if the contractor is not otherwise reimbursed (through indemnification or insurance), these losses will cut into the contractor's profit margin. Since profit in a cost-reimbursement contract with the government is limited,<sup>100</sup> this may be a severe penalty. In fact, the contract may no longer be profitable for the contractor. Recognizing that "[p]rofit, generally, is the basic motive of business enterprise,"<sup>101</sup> the government may have difficulty finding contractors to provide the goods and services it needs when the risk of unanticipated cleanup costs is great.

## B. INCREASED PRICES IN FIXED-PRICE CONTRACTS

In a fixed-price contract, contractors will most likely increase their prices commensurate with the amount of risk they bear for environmental cleanup.<sup>102</sup> This means that the government reimburses the contractor for cleanup costs in the form of higher prices. This is not inconsistent with the policy of negotiating prices that are "fair and reasonable, cost and other factors considered."<sup>103</sup>

Where the government has no CERCLA liability, the contractor alone bears the risk of unforeseen hazardous waste cleanup costs, unless the contract provides otherwise. The obvious benefit to the government of this risk allocation is illustrated by Atlas Corp. v. United States.<sup>104</sup> In this case, the Atomic Energy Commission negotiated contracts for the production of uranium concentrate and thorium, agreeing to a fixed price per pound on the basis of core cost, estimated milling costs, plant amortization, and reasonable profit. The production process generated a waste known as mill tailings. At the time the contracts were negotiated and performed, the hazardous nature of the mill tailings was unknown; only later did it become clear that this pollution source required remedial action to protect the environment. When the contractors subsequently incurred significant costs to clean up this hazardous waste, they sought reformation of the contracts to add provisions authorizing compensation for their new costs. The court held that

there was no mutual mistake of fact since the hazardous nature of the mill tailings was "not knowable at the time of the negotiations."<sup>105</sup> Reformation was therefore denied, and the government did not have to reimburse the contractors for their cleanup costs.<sup>106</sup>

Another advantage to paying the contractor to assume the risk of hazardous waste cleanup costs is the incentive this creates for the contractor to minimize costs. This is particularly true when the government does not share liability with the contractor under the provisions of CERCLA, but remains true even if the government shares CERCLA liability. If the contractor has agreed under the terms of the contract to be exclusively responsible for cleanup costs, it will likely have to reimburse the government for CERCLA liability claims paid by the government. Since the contractor has the most control over its own operations, giving the contractor the greatest incentive for safe hazardous waste disposal may save the government money.

Forcing contractors to bear the risk of hazardous waste cleanup may not always be advantageous for the government. Since cleanup costs may be difficult to predict,<sup>107</sup> contractors may over price the contract, causing the government to pay more than reasonable cleanup costs and allowing contractors excess profit. Alternatively, the contractor may underprice the contract, as occurred in Atlas Corp. v. United States.<sup>108</sup> Initially, this may appear to be a windfall for the government. Unfortunately, contractors with

excess cleanup costs may be forced out of business, and there may be no other contractors who can provide essential but exotic goods and services to the government.<sup>109</sup>

Where the government shares CERCLA liability with the contractor, paying the contractor to assume the risk of hazardous waste cleanup costs has another possible disadvantage. The government remains liable under the provisions of CERCLA, regardless of any agreement with the contractor to the contrary. In some circumstances, the government may ultimately pay twice for cleanup costs--once to the contractor in the form of higher prices, and again as a CERCLA PRP to governmental agencies or third parties who have incurred costs for cleanup. Although the government will then have a claim against the contractor for reimbursement of cleanup costs, there is a risk that the contractor may become insolvent.

### **C. INSURANCE FOR HAZARDOUS WASTE CLEANUP COSTS**

#### **1. FAR Provisions Concerning Insurance**

In certain circumstances, government contractors are required to obtain insurance. The FAR provides that "[i]nsurance is mandatory...when commingling of property, type of operation, circumstances of ownership, or condition of the contract make it necessary for the protection of the Government."<sup>110</sup>

Normally, the contractor is not required to obtain insurance if performing a fixed-price contract.<sup>111</sup> The agency may specify insurance requirements under fixed-price contracts in special circumstances, which include situations where government property is used in contract performance, or the work is to be performed on a government installation, or when the government elects to assume risks for which the contractor ordinarily obtains commercial insurance.<sup>112</sup>

In cost-reimbursement contracts, the contractor is ordinarily required to obtain certain specified amounts of insurance for workers' compensation and employer's liability; general liability; automobile liability; aircraft public and passenger liability; and vessel liability.<sup>113</sup> Generally, when the government requires a contractor to obtain insurance, the premiums are allowable costs.<sup>114</sup>

The minimum amount of general liability insurance for comprehensive bodily injury liability coverage is \$500,000 per occurrence.<sup>115</sup> Property damage liability insurance is required only in special circumstances as determined by the agency.<sup>116</sup> For example, the Army provides that such insurance may be purchased "where the exposure under contract operations is such as to warrant obtaining the claims and investigating services of an insurance carrier, e.g., for contractors engaged in the handling of high explosives or in extra-hazardous research and development activities undertaken in populated areas."<sup>117</sup>



When the contractor is required to only to "maintain" insurance, instead of purchasing insurance coverage, the contractor may be a self-insuror through an approved program.<sup>118</sup> To qualify, the contractor must demonstrate his ability to sustain the potential losses involved.<sup>119</sup>

The FAR specifically provides that agencies shall not approve programs for self-insurance for catastrophic risks.<sup>120</sup> Instead, the it provides that "[s]hould performance of Government contracts create the risk of catastrophic losses, the Government may, to the extent authorized by law, agree to indemnify the contractor or recognize an appropriate share of premiums for purchased insurance, or both."<sup>121</sup>

To summarize, the government will usually not require the contractor to maintain any insurance in a fixed-price contract. In a cost-reimbursement contract, the government usually will not require the contractor to maintain comprehensive general liability (CGL) insurance for property damage. Therefore, unless the contractor elects to obtain insurance coverage on its own, or unless special provisions are included in the contract, there will be no insurance for costs and damages arising from releases of hazardous substances and hazardous waste into the environment.

The FAR makes clear, however, that the government has the authority to require the contractor to obtain appropriate insurance when circumstances warrant it.<sup>122</sup> Arguably, the risk of unforeseen hazardous waste cleanup costs warrants insurance in some cases. From

the government's perspective, this may be especially true whenever the government has agreed to reimburse the contractor for the contractor's uninsured third party liabilities.<sup>123</sup> Insurance may also be advisable when the government shares CERCLA liability with the contractor, since the government will not have to pay CERCLA losses compensated by insurance.

## **2. Comprehensive General Liability Insurance Coverage for Hazardous Waste Cleanup Costs**

As discussed above, the government ordinarily does not require the contractor to obtain comprehensive general liability insurance for property damage. It may, however, require such insurance in appropriate cases. This, in turn, requires an examination of whether CGL insurance covers hazardous waste cleanup claims.

In the wake of CERCLA, PRPs have often turned to their insurers for relief, arguing that hazardous waste cleanup costs are covered by their CGL insurance. The standard CGL policy<sup>124</sup> provides, in pertinent part, that the insurer:

[W]ill pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of ...property damage to which this insurance applies, caused by an occurrence, and [the insurer] shall have the right and duty to

defend any suit against the insured seeking damages on account of such ...property damage, even if any of the allegations of the suit are groundless, false or fraudulent.<sup>125</sup>

Insurers have attempted, with some success, to avoid liability for hazardous waste cleanup costs by arguing that cleanup costs: (1) are not "damages" under the policy; (2) are not "property damage" under the policy; (3) are not caused by an "occurrence" as defined by the policy; (4) are excluded from coverage under the policy by the "pollution exclusion clause;" and (5) are excluded from coverage under the policy by the "owned property" exclusion. If the insurer prevails on even one of these arguments, there is no obligation to indemnify the insured for cleanup costs.

The CGL policy covers a specified period of time and usually limits the amount of the insurer's liability for each occurrence. Therefore, insurers have sought to avoid indemnifying the insured by questioning when the alleged property damage occurred and whether the claim involves more than one occurrence. Each of these issues will be discussed below to determine whether insurers are likely to avoid paying for hazardous waste cleanup costs under the terms of the standard CGL policy.

(a) Duty to Defend

In a standard CGL policy, the insurer has a duty to defend the insured in any suit seeking damages on account of property damage, "even if any of the allegations of the suit are groundless, false or fraudulent."<sup>126</sup> The duty to defend is broader than the duty to indemnify;<sup>127</sup> however, if no cause of action even potentially or arguably falls within the coverage of the policy, then the insurer is not obligated to defend.<sup>128</sup> The right to be defended is important, even if the insurer ultimately avoids reimbursing the insured for hazardous waste cleanup costs, because it saves the insured litigation costs. The insurer's duty to defend may therefore be a significant benefit.

(b) Are Cleanup Costs "Damages"?

Under the terms of the standard CGL policy, the insurance company must pay, on behalf of the insured, sums which the latter is "legally obligated to pay as damages" (emphasis added).<sup>129</sup> The courts are sharply divided on the issue of whether environmental cleanup costs are "damages" within the meaning of this provision.<sup>130</sup>

Most cases involve state or federal government claims against an insured PRP for reimbursement of the government's costs of hazardous waste cleanup. Some courts have held that these costs are claims for equitable relief rather than legal damages and

therefore are not covered by CGL insurance.<sup>131</sup> Other courts, although agreeing that the government claims are for equitable relief, have held that the term "damages" in the standard CGL policy includes the cost of such relief.<sup>132</sup> Since state law governs the construction of standard-form CGL insurance policies,<sup>133</sup> the result in these disputes may hinge on which state's law is applied.

In Continental Ins. Co. v. N.E. Pharmaceutical & Chem. Co. (NEPACCO), the Eighth Circuit held that an insurer was not obligated to indemnify an insured chemical company for the costs of cleaning up sites damaged by the chemical company's hazardous waste.<sup>134</sup> The court's rationale for holding that the cleanup costs were not "damages" was based on the following conclusions: (1) under Missouri law, the term "damages" is not ambiguous, and in the insurance context it refers to legal damages; (2) without this limited construction, the term "damages" would become mere surplusage, and any obligation of the insured to pay on any type of claim would be covered, and; (3) limiting the meaning of the term "damages" to legal damages is consistent with the statutory scheme of CERCLA, which distinguishes between cleanup costs under section 107(a)(4)(A) & (B) and damages for loss or destruction of natural resources under section 107(a)(4)(C).<sup>135</sup>

According to the NEPACCO court, "the type of relief sought is critical to the insured and the insurer, because under the CGL policies the insurer is liable only for legal damages, not for equitable

monetary relief."<sup>136</sup> The court characterized the lawsuits by federal and state governments seeking recovery of cleanup costs under CERCLA section 107(a)(4)(A) as "essentially equitable actions for monetary relief in the form of restitution or reimbursement of costs."<sup>137</sup> Noting that the cost of cleaning up a hazardous waste site often exceeds its original value, the NEPACCO court rejected the argument that cleanup costs are simply a measure of damages to natural resources.<sup>138</sup>

This distinction between legal damages and equitable relief has been rejected by a number of other courts, however.<sup>139</sup> They disagree with the conclusion in NEPACCO that the type of relief sought should determine whether the insured is covered under the CGL policy. As one court stated,

[i]f the state were to sue in court to recover traditional 'damages', including the state's costs incurred in cleaning up the contamination, for the injury to the groundwater, [the insurer's] obligation to defend against the lawsuit and to pay damages would be clear. It is merely fortuitous from the standpoint of either [the insured] or [the insurer] that the state has chosen to have [the insured] remedy the contamination problem, rather than choosing to incur the costs of clean-up itself and then suing [the insured] to recover those costs. The damage

to the natural resources is simply measured in the cost to restore the water to its original state. [citations omitted]<sup>140</sup>

If cleanup costs are not "damages" within the meaning of the standard CGL policy, the insurer has no indemnification obligation. As the cases discussed above illustrate, the answer to this question often depends on which court is considering the issue. Even when the court decides that cleanup costs are "damages," however, the insurer may still avoid liability on any of several additional theories.

(c) Are Cleanup Costs "Property Damage"?

Under the provisions of the standard CGL policy, the insurer must pay sums which the insured is "obliged to pay as damages because of property damage" (emphasis added).<sup>141</sup> "Property damage" is defined in the policy as:

- (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or
- (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.<sup>142</sup>

Closely related to the argument that cleanup costs are not "damages" is the argument that they are not "property damage" within the meaning of the policy. For example, in Port of Portland v. Water Quality Ins. Syndicate the defendant insurance company argued that oil pollution of water was not damage to tangible property.<sup>143</sup> The court rejected this argument and held that discharge of pollution into water causes damage to tangible property.<sup>144</sup> Thus, the cleanup costs were recoverable under a property damage liability clause.<sup>145</sup> Going one step further, the court in Kipin Indus., Inc. v. American Universal Ins. Co.<sup>146</sup> held that:

"[P]roperty" includes the interests of the federal and the state governments in the tangible environment and its safety. Thus, when the environment has been adversely affected by pollution to the extent of requiring governmental action or expenditure or both for the safety of the public, there is 'property damage' whether or not the pollution affects any tangible property owned or possessed exclusively by the government.<sup>147</sup>

Not all courts have adopted this view. In Mraz v. Canadian Universal Ins. Co., Ltd., the court held that the costs incurred by the United States and the State of Maryland in cleaning up hazardous waste generated by the insured were not "property damage" within the meaning of the CGL policy.<sup>148</sup> According to the Mraz



court, "[o]ne cannot equate response costs with "injury to or destruction of tangible property".<sup>149</sup> Instead, the court characterized response costs as an economic loss.<sup>150</sup>

If the court finds that property damage has occurred, the insured need not allege that the underlying claim is for property damage.<sup>151</sup> Rather, the policy states that the insurer will pay sums the insured is "legally obliged to pay as damages because of property damage"<sup>152</sup> (emphasis added). Thus, the insurer is required to pay the insured for all resulting damages that flow from the property damage, including cleanup costs, claims for diminished economic value, damages for compensation in relocating individuals, and damages based on harm to the economic activity of businesses in the polluted area.<sup>153</sup>

**(d) Do Cleanup Costs Represent Property Damage  
That Was Caused by an "Occurrence"?**

The insurer is only obligated to indemnify the insured for damages the insured is legally obliged to pay for property damage "caused by an occurrence" (emphasis added).<sup>154</sup> An "occurrence" is defined as "an accident, including continuous or repeated exposure to conditions, which results in...property damage neither expected nor intended from the standpoint of the insured."<sup>155</sup> Therefore, if the insured either expected or intended the property damage, there is no coverage under the policy.

The definition of "occurrence" includes losses from continuing operations as well as a sudden event, as long as the loss was unexpected.<sup>156</sup> Whether the event is unexpected should be determined "from the standpoint of the insured".<sup>157</sup> Intentional acts may qualify as "occurrences", as long as the consequences are unexpected.<sup>158</sup> Cleanup costs, even those resulting from gradual pollution, may be considered property damage caused by an occurrence as long as the property damage was unexpected. If it is shown that the insured polluter knew or should have known of the ongoing pollution, however, coverage may be denied.<sup>159</sup>

#### (e) Trigger of Coverage

In order to be covered by the standard CGL insurance policy, the property damage must have been "caused by an occurrence during the policy period."<sup>160</sup> In many hazardous waste cleanup cases, the damage occurs over a long period of time and may not have occurred, or been discovered until long after the hazardous waste was disposed of. Cleanup costs may not be assessed until some time thereafter. During the period in question, the insured may have had several different CGL insurers with different aggregate limits, deductibles and exclusions. The determination of when the damage occurred for purposes of triggering an insurer's policy obligations thus becomes a critical question.

The courts have adopted several theories to determine the trigger of coverage in hazardous waste cleanup cases. Policy coverage may be triggered when the hazardous waste was dumped (the wrongful act), when the release occurred (exposure), when the environment was contaminated (injury-in-fact), when the damage was discovered (manifestation), or when cleanup costs were incurred.<sup>181</sup>

The general rule is that property damage occurs not at the time the wrongful act is committed but when the complaining party is actually damaged (the injury-in-fact theory).<sup>182</sup> Where the leakage of hazardous waste remains concealed for a period of time, determining exactly when damage begins can be difficult.<sup>183</sup> For this reason, the Fourth Circuit Court of Appeals in Mraz v. Can. Universal Ins. Co., Ltd. held that in hazardous waste burial cases, the trigger of coverage is the time when the leakage and damage are first discovered.<sup>184</sup>

In a later case, the Eighth Circuit adopted the view that environmental damage occurs at the moment hazardous wastes are improperly released (the exposure theory of coverage).<sup>185</sup> Under this theory, a liability policy in effect at the time of release provides coverage for the subsequently incurred costs of cleaning up the wastes.<sup>186</sup> The court noted that this parallels the rule established in the analogous situation of insurance coverage for asbestos claims.<sup>187</sup>

Where it is difficult to determine when the improper release or damage occurred, a "continuous

trigger", from the date of the first dumping until the discovery of the damage, may be the most appropriate theory. For example, the court in Lac D'Amiante Du Quebec, Ltee v. American Home Assurance Co. adopted a continuous trigger of coverage where the injury to property caused by asbestos was continuous and progressive and not complete at the act of installation.<sup>168</sup> In this situation, more than one policy may be triggered.

These cases illustrate that an insurer's liability for cleanup costs may depend on which theory the court employs to determine when the injury or liability producing event occurs. In one jurisdiction the insurer may escape liability because the release was not discovered during the insurance policy coverage dates,<sup>169</sup> while he may be held liable in another jurisdiction if the release occurred during the policy period, regardless of when it was discovered.<sup>170</sup>

#### (f) Number of Occurrences

CGL insurance policies usually limit the insurer's liability for bodily injury and property damage per occurrence, and they often provide aggregate limits as well. In a hazardous waste cleanup case, the damage may have occurred over a long period of time, arguably as the result of several "causes," and several people or pieces of property may be effected. The issue of how many occurrences can be said to have taken place is therefore a complicated one. The insurer will argue

that all injury or damage occurring during the policy period caused by the same conditions or repeated exposure is one occurrence, while the insured would obviously like to characterize the damage as being caused by more than one occurrence. Where the policy provides for a liability limit per occurrence, and where the insurer's liability is not limited by the aggregate amount, the number of occurrences the court finds may dramatically effect the insurer's liability to indemnify the insured for hazardous waste cleanup costs.

In the non-pollution context, the majority view is that the number of occurrences is determined by the number of causes of the damage and not the number of damages sustained (the cause rule).<sup>171</sup> Under this rule, if there are multiple causes, there may be multiple occurrences. The minority view is that the number of occurrences is the number of resulting damages (the effect rule).<sup>172</sup>

One of the few hazardous waste cases to decide this issue applied both the cause and effect rule to determine that several occurrences had taken place. In Township of Jackson v. American Home Assurance Co.<sup>173</sup> hazardous wastes seeped from a landfill and contaminated the drinking water supply of nearby residents. The insured municipality sought recovery for its cleanup costs from its CGL insurer. The court found that "separate, independent causative events," including failure to manage incoming waste amounts, ignoring signs of contamination, permitting ponding to

occur, failure to inspect tank trucks, and digging below the water table had taken place. Each of these could be considered a separate occurrence.<sup>174</sup> The court noted multiple occurrences would also be the result of applying the effect rule, since several wells were contaminated.<sup>175</sup> Since the number of occurrences under either rule was enough to cover the entire amount sought by the insured, the court held the insurer liable for the entire amount without determining which rule should apply.<sup>176</sup>

**(g) Application of the Pollution Exclusion Clause**

In the early 1970's, many CGL policies added a clause which excludes coverage for certain kinds of pollution damage. That standard CGL pollution exclusion clause provided that insurance would not apply to:

[P]roperty damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.<sup>177</sup>

With the incorporation of this limitation, insurers have sought to avoid indemnification for hazardous waste cleanup costs. Insured entities have argued, however, that the pollution was "sudden and accidental," and therefore covered. Most of the case law concerning the interpretation of this clause therefore focuses on the meaning of the phrase "sudden and accidental."<sup>178</sup>

Some courts have held that the term "sudden and accidental" is ambiguous in the context of the pollution exclusion clause, and therefore should be strictly construed against the insurer.<sup>179</sup> In so doing, they reject the insurers' contention that the word sudden means an instantaneous happening.<sup>180</sup> The courts note that term is not defined in the CGL policy itself, and the primary dictionary definition of the word "sudden" is "happening without previous notice" or "occurring unexpectedly."<sup>181</sup> Therefore, the pollution exclusion clause has been considered by some courts to merely clarify the definition of "occurrence."<sup>182</sup> Damages resulting from an unexpected discharge of pollutants are covered, regardless of whether the discharge is instantaneous.<sup>183</sup>

Not all courts adopted this interpretation. Some have concluded instead that the pollution exclusion clause provides coverage only if the damage was caused by a release of pollutants occurring both unexpectedly and relatively quickly in time.<sup>184</sup> For example, in holding that a CGL insurer had no duty to defend or indemnify the insured in a suit arising out of a

chemical company's disposal of hazardous wastes, the court in United States Fidelity & Guar. Co. v. Murray Ohio Mfg. Co. stated:

The proof in this case shows that Murray Ohio had its waste transported to and disposed of at the CCC site under contract for approximately six years. No breakdown in machinery, precipitous leak, or other "sudden" event occurred. The amended complaint...speaks of long periods of time over which the pollution occurred, as opposed to any instantaneous event or events which occurred over a brief period. Thus, applying the pollution exclusion clause's "sudden and accidental" exception to these facts leaves no room for ambiguity. Simply put, an event that occurs over the course of six years logically cannot be said to be "sudden."<sup>185</sup>

There has been some disagreement whether only the release, or the resulting damage, or both, must be "sudden and accidental" for the property damage to fall outside the pollution exclusion clause. In Fireman's Fund Ins. Co. v. Ex-Cell-O Corp., the court stated that "[t]he decisive inquiry is not whether the policyholders anticipated property damage, or whether they regularly disposed of hazardous waste, but whether the pollutants entered the environment unexpectedly and unintentionally."<sup>186</sup> Other courts have held that even



if the act was intentional, the resulting damage may be covered by the CGL policy if it was unexpected.<sup>187</sup> Some courts have held that both the release and the resulting damage must be accidental for coverage to exist.<sup>188</sup>

Judges will continue to address these issues in claims arising under the early version of the pollution exclusion clause. The Insurance Services Office developed a new standard clause in 1986, however, and this provision will likely result in more victories for insurers. It excludes coverage for "[a]ny loss, cost, or expense arising out of any governmental direction or request that [the insured] test for, monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants."<sup>189</sup> The revised standard CGL policy also excludes injury or damage "arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants."<sup>190</sup>

#### (h) Application of the Owned Property Exclusion

Insurers will often argue that cleanup costs are excluded from coverage under the standard CGL insurance policy because they result from damage to property owned by the insured. The standard CGL insurance policy does not cover property damage to:

- (1) property owned or occupied by or rented to the insured,
- (2) property used by the insured, or

(3) property in the care, custody or control of the insured or as to which the insured is for any purpose exercising physical control.<sup>181</sup>

The rationale behind this exclusion is that it will encourage the policyholder to manage his own property in a responsible fashion.<sup>182</sup>

The courts generally have held that remedies designed to prevent damage to property owned by third parties are not excluded from coverage on the basis of the owned-property exclusion, even if the remedy takes place on property owned by the insured.<sup>183</sup> For example, in Township of Gloucester v. Md. Casualty Co. the court saw no problem with the fact that expenditures would be made in part to repair property owned by the insured since the costs were inextricably linked to damage claims of a third party.<sup>184</sup> Similarly, in United States Aviex Co. v. Travelers Ins. Co. the court held that damage to the groundwater beneath the insured's property was not excluded from coverage by the owned-property exclusion since the insured did not own the groundwater.<sup>185</sup>

### 3. Environmental Impairment Liability Insurance

Environmental Impairment Liability (EIL) insurance was developed by the insurance industry in 1981 to provide coverage for gradual and sudden pollution.<sup>186</sup> The standard EIL policy provides coverage for property

damage, bodily injury, and other economic losses caused by sudden or gradual pollution, and it covers cleanup costs as well.<sup>197</sup>

Unfortunately, EIL policies generally are not available.<sup>198</sup> As the General Accounting Office noted in its 1987 report to Congress concerning pollution insurance availability:

The supply of pollution insurance currently available to the hazardous substance industry is limited. Only one insurance industry source, [American International Group], is actively pursuing the pollution insurance market. A few other companies write pollution insurance for selected clients who carry coverage for other risks.

The remainder of the insurance industry, for the most part, regards pollution risks as uninsurable. These companies cite unfavorable legal trends and potentially enormous claim payments for their withdrawal from the market over the last few years and their reluctance to underwrite pollution risks...[I]nsurers maintain that the combination of the inherent risk of insuring against pollution, uncertainty about judicial decisions regarding liability standards and insurance contract coverage for pollution incidents, and broad liability established by

federal environmental law made it too difficult for them to write new pollution insurance at a profit. More importantly, insurers claim that these aspects of current pollution liability may prevent their future reentry into the pollution insurance market, even as the overall insurance industry recovers its financial position.<sup>199</sup>

#### **D. GOVERNMENT INDEMNIFICATION**

CERCLA does not prohibit parties from entering into agreements to indemnify or hold harmless another party for liability arising from hazardous waste cleanup.<sup>200</sup> Therefore, two questions arise: can DoD enter into such agreements with defense contractors; and should it do so? The answer to both questions is yes, in limited circumstances.

##### **1. Statutory Limits: the Anti-Deficiency Act**

The primary limitation on DoD's authority to enter into agreements to indemnify government contractors is the Anti-Deficiency Act (ADA). The ADA provides that the Federal Government may not: (1) make or authorize an expenditure or obligation of funds in excess of current appropriations, or (2) involve the government in a contract or obligation for the payment of money in advance of appropriations unless authorized by law.<sup>201</sup> The Comptroller General and the courts agree that the

ADA ordinarily prohibits contractual indemnity agreements that might subject the government to unlimited liability.<sup>202</sup>

In spite of the limitations imposed by the ADA, however, there are two situations where an indemnity agreement is permissible in government contracts.<sup>203</sup> First, the ADA prohibition against obligations in advance of appropriations specifically excepts such obligations if "authorized by law." Therefore, if there is specific statutory authority to enter into an indemnity agreement, the agreement is not prohibited by the ADA.<sup>204</sup> Second, if the indemnity agreement limits government liability by establishing a cap, it will not violate the ADA unless government liability exceeds appropriations.<sup>205</sup>

## **2. Insurance-Liability to Third Persons Clauses in Cost-Reimbursement Contracts**

In cost-reimbursement contracts, the government normally agrees to indemnify the contractor for certain uninsured third-party liabilities.<sup>206</sup> The "Insurance-Liability to Third Persons" clause used in most government cost-reimbursement contracts<sup>207</sup> provides that the contractor will be reimbursed for certain uninsured liabilities to third persons without regard to the limitation of cost or the limitation of funds clause of the contract. These liabilities are for property damage, death, or bodily injury arising out of the performance of the contract. Liabilities caused by the

contractor's negligence are included, but liabilities that result from willful misconduct or lack of good faith on the part of the contractor are not.

Most cleanup costs incurred by the contractor in a cost-reimbursement contract that are not allowable costs under other FAR provisions<sup>208</sup> will be covered by the "Insurance-Liability to Third Persons" clause. Covered cleanup costs must be liabilities for loss of or damage to property arising out of the performance of the contract. Cleanup costs that are otherwise insured, and cleanup costs that were incurred due to the willful misconduct or lack of good faith on the part of the contractor will not be covered.

In recognition of the ADA limitations, the "Insurance-Liability to Third Persons" clause specifically provides that the government's liability is subject to the availability of appropriated funds at the time the contingency occurs.<sup>209</sup> Further, the clause states that "[n]othing in this contract shall be construed as implying that the Congress will, at a later date, appropriate funds sufficient to meet deficiencies."<sup>210</sup> In view of this provision, the "Insurance-Liability to Third Persons" clause provides only limited protection to government contractors, since they may only be reimbursed to the extent of available funds.<sup>211</sup>

### 3. Statutory Authority

#### (a) 10 U.S.C. sec. 2354: Research & Development

Specific statutory authority exists to indemnify contractors involved in research and development for a military department.<sup>212</sup> Pursuant to 10 U.S.C. section 2354, DoD may indemnify the contractor and subcontractor for uninsured losses that arise out of the direct performance of the contract, and that result from a risk that the contract defines as "unusually hazardous."<sup>213</sup> Specifically excluded are losses that result from willful misconduct or lack of good faith on the part of the contractor or its agents.<sup>214</sup> Use of this indemnification provision must be authorized by the Secretary concerned, or his designee.<sup>215</sup>

Cleanup costs may be reimbursed pursuant to the authority of 10 U.S.C. section 2354 only in limited circumstances. All of the following conditions must be met: (1) the contract is for research and development; (2) the cleanup costs result from a risk that the contract defines as "unusually hazardous"; (3) the cleanup costs arise out of direct performance of the contract; (4) the cleanup costs are not compensated by insurance or otherwise; and (5) the cleanup costs are not a result of the contractor's willful misconduct or lack of good faith.

(b) Public Law 85-804

Public Law 85-804, the National Defense Contracts Act,<sup>216</sup> provides much broader authority for DoD to indemnify contractors than that provided pursuant to 10 U.S.C. section 2354. Public Law 85-804 provides that:

The President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense.<sup>217</sup>

This broad authority to enter into contracts "without regard to other provisions of law" has only one limitation as prescribed in the statute itself--the action must "facilitate national defense."<sup>218</sup> The statute does not limit authority to take such action to DoD. Indeed, the Executive Order implementing the statute names eleven civilian agencies who may take action pursuant to this authority.<sup>219</sup>



Although the statute itself does not mention indemnification of contractors, the legislative history of the Act makes it clear that Congress intended to provide such authority under the Act.<sup>220</sup>

[T]he departments authorized to use this authority have heretofore utilized it as the basis for the making of indemnity payments under certain contracts. The need for indemnity clauses in most cases arises from the advent of nuclear power and the use of highly volatile fuels in the missile program. The magnitude of the risks involved under procurement contracts in these areas have rendered commercial insurance either unavailable or limited in coverage. At the present time, military departments have specific authority to indemnify contractors who are engaged in hazardous research and development, but this authority does not extend to production contracts (10 U.S.C. 2354). Nevertheless, production contracts may involve items, the production of which may include a substantial element of risk, giving rise to the possibility of an enormous amount of claims. It is, therefore, the position of the military departments that to the extent that commercial insurance is unavailable, the risk of loss in such a case should be borne by the United States.<sup>221</sup>

The Executive Order implementing the statute limits contractor indemnification to claims or losses arising out of risks that the contract defines as unusually hazardous or nuclear in nature.<sup>222</sup> The Executive Order further provides that such a contractual provision shall be approved in advance by an official at a level not below that of the Secretary of a military department.<sup>223</sup> An indemnified contractor may be required to provide and maintain financial protection of such type and in such amounts as is determined to be appropriate by the approving official.<sup>224</sup> In deciding whether to provide indemnification, and in determining the amount of financial protection to be provided and maintained by the contractor, the Executive Order provides that the approving official shall take into account such factors as: the availability, cost, and terms of private insurance, self-insurance, other proof of financial responsibility, and workmen's compensation insurance.<sup>225</sup>

The Executive Order provides that contractual indemnification shall apply to losses not compensated by insurance, including: (1) claims by third persons, including employees of the contractor, for death, personal injury, or property damage; (2) damage or loss of use of the contractor's property; (3) damage or loss of use of government property; and (4) claims arising from indemnification agreements between the contractor and the subcontractor.<sup>226</sup> Not covered are claims by the United States (other than those arising through

subrogation) against the contractor or subcontractor, or losses affecting the property of the contractor or subcontractor, if such claims are caused by willful misconduct or lack of good faith on the part of the contractor's or subcontractor's directors or officers.<sup>227</sup>

The FAR provides that contractor requests for indemnification to cover unusually hazardous or nuclear risks shall be submitted to the contracting officer.<sup>228</sup> The contracting officer may deny the request, or forward it through channels to the appropriate official for approval.<sup>229</sup> The contracting officer's recommendation for approval must include (among others): (1) a definition of the unusually hazardous or nuclear risks involved in the proposed contract with a statement that all parties have agreed to it; (2) a statement by responsible authority that the indemnification action would facilitate national defense;<sup>230</sup> and (3) a statement that the contract will involve unusually hazardous or nuclear risks that could impose liability upon the contractor in excess of financial protection reasonably available.<sup>231</sup>

The Executive Order does not define the term "unusually hazardous." It is therefore not clear whether the term refers only to activities and products that are themselves dangerous (such as explosives), or also includes the risk of very large uninsurable claims.<sup>232</sup> In 1981, the Department of Transportation recognized that an "unusually hazardous risk" could include the risk of uninsured catastrophic loss when it

authorized indemnification under Public Law 85-804 for contractors engaged in the upgrading of FAA's computer assisted air traffic control system.<sup>233</sup> While the secretary found that there was a low probability of a malfunction in the system,

[i]n the event that such a malfunction leads to an accident, the potential claimants would be quite numerous, and the severity of potential damage could be catastrophic. While the risk of a catastrophic accident may be remote, if it occurs, it could be far in excess of the insurance coverage that reliably and reasonably could be obtained by manufacturers in the marketplace for the life of the system.<sup>234</sup>

This interpretation is consistent with the purpose of the National Defense Contracts Act to have the government bear the risk of loss to the extent that commercial insurance is unavailable.

DoD has not formally defined the "unusually hazardous" risks for which the government should provide indemnification under Public Law 85-804. In testimony before a Congressional subcommittee considering proposed legislation on government contractor indemnification, Ms. Eleanor R. Spector, Assistant Secretary of Defense for Procurement, stated that:

The Department of Defense agrees that there is a need to provide indemnification to Government contractors in certain circumstances in which to Government requires work to be done for which the risks are great and for which insurance is not realistically obtainable...By the authority of Public Law 85-804 as implemented, we can indemnify against unusually hazardous risk and nuclear risk. The determination of what risks under a contract are indeed unusually hazardous or nuclear so as to warrant the extraordinary measure of indemnification necessarily is with the military department writing the contract, for there rests the greatest expertise on the precise nature of the risks for the activity involved under the contract.<sup>235</sup>

The military department concerned therefore has great discretion in defining what risks under a contract are "unusually hazardous." The definition may include inherently dangerous activity as well as the risk of catastrophic loss.

The government may indemnify contractors for the risk of hazardous waste cleanup costs, pursuant to Public Law 85-804, when the contract involves a product or activity that is unusually hazardous by its very nature. Such activities might include, for example, a

contract to dispose of leaking drums containing hazardous wastes.

The government may also indemnify contractors pursuant to Public Law 85-804 when the product or activity itself is not unusually hazardous, but involves a remote risk of catastrophic loss to the contractor. For example, when the contractor manufactures a product for the government and the manufacturing process generates hazardous waste, the contractor may be liable for significant cleanup costs. The contractor may incur these costs in spite of its best efforts to safely dispose of the hazardous waste, and such losses are not likely to be covered by insurance. Although the risk of incurring cleanup costs may be remote, the severity of the potential damage could be catastrophic. The risk of loss in this situation is also "unusually hazardous", and the contractor should be eligible for indemnification under Public Law 85-804.

#### **4. DoD Experience with Contractor Indemnification**

The indemnification authority provided by 10 U.S.C. section 2354 and Public Law 85-804 is used only in exceptional circumstances in DoD. According to the DoD "Summary Reports,"<sup>238</sup> provisions to indemnify contractors against liabilities because of death or injury or property damage arising out of "unusually hazardous" risks have been used very sparingly:

<u>Calendar Year</u>	<u>Contracts providing for</u> <u>Indemnification</u>
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1983	53
1984	50
1985	56
1986	52
1987	30

To put these numbers in perspective, the Department of Defense awards over 15 million contracts each year.<sup>237</sup> Indemnification provisions are used in less than 1/1000 of 1% of those contract actions.

The DoD position is that the indemnity authority provided under 10 U.S.C. section 2354 and Public Law 85-804 is adequate for DoD's needs and that additional indemnification legislation is not needed.<sup>238</sup>

## V. CONCLUSIONS

Reasonable costs to avoid pollution should be paid by DoD as allowable costs in cost-reimbursement contracts since they are ordinary and necessary for the conduct of the contractor's business or the contract performance. Similarly, cleanup costs incurred as a result of innocent, non-negligent pollution should be allowable costs. Cleanup costs that are incurred due to simple or gross negligence may be allowable, depending on the degree of contractor culpability. Cleanup costs resulting from non-compliance with laws

and regulations are not allowable since they are not "reasonable."

Even when cleanup costs are allowable costs in cost-reimbursement contracts, the contractor's recovery of such costs from the government may be limited by the cost ceiling in the contract. Unless otherwise compensated, the contractor may suffer catastrophic loss. This may have an adverse impact on the ability of DoD to contract for essential goods and services.

In fixed-price contracts, contractors may not be able to cover the risk of hazardous waste cleanup costs by increasing their prices because of the uncertainty of calculating the potential losses. Alternatively, the contractor may over price the contract. Either the government may pay more than its fair share of the risk of hazardous waste damage, or the contractor may bear more than its fair share of cleanup costs. This may have an adverse impact on the government's ability to obtain essential goods and services at a reasonable price.

When DoD shares CERCLA liability with the contractor, even if DoD pays the contractor for cleanup costs in the form of higher prices, DoD may still have to pay cleanup costs to third parties. DoD may in some cases pay twice for cleanup costs.

Comprehensive General Liability insurance will not reimburse the contractor for hazardous waste cleanup costs. Even if the court considers these costs "damages" as defined by the policy, such losses will likely be excluded by the pollution exclusion clause.



Although Environmental Impairment Liability insurance would cover cleanup costs, it is not likely to be available to the contractor.

The current "Insurance-Liability to Third Persons" clause in cost-reimbursement contracts is inadequate to reimburse the contractor for cleanup costs in light of the ADA limitations. 10 U.S.C. section 2354 may be used to reimburse contractors for cleanup costs in research and development contracts if the cleanup costs result from a risk that the contract defines as "unusually hazardous." Similarly, Public Law 85-804 could be used to reimburse contractors for cleanup costs if the loss results from a risk that the contract defines as "unusually hazardous." For example, contracts that involve transporting or disposing of hazardous waste may be considered "unusually hazardous". Contracts where hazardous waste is merely a by-product of the production process may also be included in this definition if the contract involves the risk of uninsured catastrophic loss.

## **VI. RECOMMENDATIONS**

Reasonable costs to avoid pollution should be paid by DoD as allowable costs in cost-reimbursement contracts. This authorization will save the government money in the long run because pollution avoidance is usually much less expensive than cleaning up hazardous waste contamination.

To the extent that funds are available, the contractor performing a cost-reimbursement contract should also be reimbursed for cleanup costs resulting from innocent, non-negligent pollution, and in some cases, for costs associated with a release caused by contractor negligence.

Paying for hazardous waste cleanup costs in cost-reimbursement contracts is advantageous to DoD since contractors performing these contracts expect to be reimbursed for most of the costs of performance, and to make a limited profit. If DoD requires the contractor to bear the risk of hazardous waste cleanup costs associated with contract performance, the contract may no longer be profitable. Contractors may eventually decline to contract with DoD.

DoD should not require the contractor to obtain CGL insurance to cover potential hazardous waste cleanup costs because the insurance will not cover the risks that the contractor and DoD face. DoD also should not reimburse the contractor for the cost of such insurance, unless DoD desires the contractor to maintain CGL insurance for other reasons, such as to cover losses other than cleanup costs.

DoD should investigate the availability of Environmental Impairment Liability insurance to cover the cost of hazardous waste cleanup. If available at a reasonable cost, DoD should consider requiring the contractor to obtain such insurance on a case-by-case basis. In cost-reimbursement contracts, DoD should

reimburse the contractor for the cost of such insurance.

In cost-reimbursement contracts, DoD should indemnify contractors pursuant to 10 U.S.C. section 2354 or Public Law 85-804 for the risk of uninsured hazardous waste cleanup costs. This indemnification will cover most contractor losses for hazardous waste cleanup costs that would not otherwise be reimbursable because of funding limitations.

In fixed-price contracts, DoD should indemnify contractors pursuant to 10 U.S.C. section 2354 or Public Law 85-804 for the costs of hazardous waste cleanup if DoD shares CERCLA liability with the contractor. Otherwise, DoD may ultimately pay twice for cleanup costs.

Where DoD does not share liability with the contractor pursuant to CERCLA, DoD usually should not indemnify the contractor in fixed-price contracts. This will mean, however, that DoD effectively will pay in the form of higher prices for the risk that cleanup costs will be incurred.

In the rare situation where no contractors are willing to assume the risk of hazardous waste cleanup costs, DoD should indemnify contractors in fixed-price contracts even if DoD does not share liability with the contractor under the provisions of CERCLA. Indemnification is also appropriate if the facts and circumstances indicate that DoD is paying excess profit rather than a reasonable cost for the risk of hazardous waste damage.

Indemnification under Public Law 85-804 or 10 U.S.C. section 2354 will insure that DoD can obtain necessary goods and services, even if the risk of catastrophic loss due to hazardous waste damage is great. Although an indemnified contractor will have fewer incentives to minimize hazardous waste cleanup costs, indemnification under Public Law 85-804 or 10 U.S.C. section 2354 is not absolute. Excluded would be losses caused by willful misconduct or lack of good faith on the part of the contractor.

The standard indemnification clauses for Public Law 85-804<sup>239</sup> and 10 U.S.C. 2354<sup>240</sup> provide that the indemnification applies only to the extent that the claim, loss, or damage arises from a risk defined in the contract as unusually hazardous or nuclear. To limit indemnification to hazardous waste cleanup costs, the contract should define the "unusually hazardous" risk as the risk of property damage arising out of actual, alleged or threatened discharge, dispersal, release or escape of pollutants, including any loss, cost, or expense arising out of any governmental direction or request that the contractor test for, monitor, clean up, remove, contain, treat, detoxify, or neutralize the pollutants.<sup>241</sup>

## ENDNOTES

1. Text of President Bush's Address to Congress, Wash. Post, Feb. 10, 1989, at A20, col. 3.

2. Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. secs. 9601-9657 (1982 & Supp. IV 1986)).

3. For an excellent discussion of the purpose and legislative history of the Act, see *United States v. Chem-Dyne Corp.*, 572 F.Supp. 802, 805-808 (S.D. Ohio 1983).

4. 42 U.S.C. secs. 9604, 9607, 9611 (1982 & Supp. IV 1986).

5. Id. at sec. 9607(a).

6. See, e.g., *United States v. Conservation Chem. Co.*, 589 F. Supp. 59, 62-63 (W.D. Mo. 1984); *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 805, 810 (S.D. Ohio 1983).

7. Pub. L. No. 99-499, sec. 120, 100 Stat. 1614 (codified at 42 U.S.C. sec. 9620 (Supp. IV 1986)). Congress has indicated special concern about cleanup at DoD facilities/activities. Section 211 of SARA established the "Defense Environmental Restoration Program" to identify and cleanup contamination from hazardous waste at DoD facilities. 10 U.S.C. secs. 2701-2707 & 2810 (1986). The legislation created an "environmental restoration transfer account" to pay for the environmental restoration mandated by the Defense Environmental Restoration Program or any other provision of law. DoD must report annually to Congress concerning progress made in implementation of the program.

8. Although there is statutory authority for the President to exempt a particular DoD facility from CERCLA requirements, such authority is limited. The exemption must be necessary to protect national

security interests of the United States at the DoD site or facility. Further, the exemption may not be granted due to lack of appropriation unless the President has specifically requested such appropriation as part of the budgetary process and Congress has failed to make available the requested appropriation. Congress must be notified within 30 days of any such exemption. Exemptions must be for a specified period, not to exceed one year. 42 U.S.C. sec. 9620(j) (Supp. IV 1986).

9. DoD's Annual Report to Congress for Fiscal Year 1987 on activities of the Defense Environmental Restoration Program, 19 Env't Rep. 44 (BNA) (May 13, 1988).

10. Satchell, Uncle Sam's Toxic Folly, U.S. News & World Rep., March 27, 1989, at 20, 22.

11. This is especially true at the many government-owned, contractor-operated (GOCO) facilities. See infra part II(A).

12. The term "cleanup costs" as used in this thesis refers to remedial actions to cleanup hazardous waste under 42 U.S.C. sec. 9607(a)(4)(A) (1982) and response costs under 42 U.S.C. sec. 9607(a)(4)(B) (1982).

13. 42 U.S.C. sec. 9607(a) (1982).

14. See, e.g., New York v. Shore Realty Corp., 759 F.2d 1032, 1044 (2d Cir. 1985) (present owner found liable for costs to cleanup hazardous material disposed on his property, even though he had not participated in the generation or transportation of the waste, or caused the release).

15. Disposal is "...the discharge, deposit, injection, dumping, spilling, leaking or placing of any solid waste or hazardous waste into or on any land or water so that such solid waste or hazardous waste or any constituent thereof may enter the environment or be emitted into the air or discharged into any waters, including ground waters." 42 U.S.C. sec. 9601(29) (1982) (incorporating 42 U.S.C. sec. 6903(3) (1982)). "[S]ignificantly [this definition] includes within its

purview leaking, which ordinarily occurs not through affirmative action, but as a result of inaction or negligent past actions." United States v. Price, 523 F.Supp. 1055, 1071 (D.N.J. 1981), aff'd, 688 F.2d 204 (3d Cir. 1982).

16. E.g., Emhart Indus., Inc. v. Duracell Int'l Inc., 665 F.Supp. 549, 574 (M.D. Tenn. 1987).

17. DoD is also potentially liable as a "generator" or "transporter" where government activities result in hazardous waste generation, or where the government is involved in transporting or disposing of hazardous waste.

18. See Environmental Protection Agency, Federal Facilities Compliance Strategy III-7 (1988) for a complete list of terms and definitions of facilities with federal involvement.

19. United States v. N.E. Pharmaceutical and Chem. Co., Inc., 579 F.Supp. 823, 847 (W.D. Mo. 1984). But see United States v. Ward, 618 F.Supp. 884, 893 (D. N.C. 1985) (in order to establish liability under section 107(a)(3) the government must prove the defendant owned or possessed hazardous substances).

20. United States v. Bliss, 667 F.Supp. 1298, 1306 (E.D.Mo. 1987).

21. United States v. A & F Materials Co., Inc., 582 F.Supp. 842, 845 (S.D.Ill. 1984), cited with approval in Jersey City Redevelopment Auth. v. PPG Indus., 655 F.Supp. 1257, 1260 (D.N.J. 1987) and Allied Towing Corp. v. Great E. Petroleum Corp., 642 F.Supp. 1339, 1350 (E.D.Va. 1986).

22. Jones v. Inmont Corp., 584 F.Supp. 1425, 1428-29 (S.D.Ohio 1984).

23. S.Rep. No. 96-848, 96th Cong., 2d Sess. 31 (1980), quoted in New York v. General Electric Co., 592 F.Supp. 291, 297 (N.D.N.Y. 1985).

24. See e.g., New York v. General Elec. Co. at 297. In this case, the defendant sold drums of used transformer oil containing hazardous substances to a drag strip. The defendant argued that he had not arranged for disposal of the waste since he sold the oil to be used as the dragway owner saw fit and did not enter into an agreement to have the oil deposited or otherwise placed on the drag strip. Rejecting this argument, the court held the plaintiff was a PRP under section 107(a)(3).

25. Even if CERCLA imposes no liability on the government, the government may share contractor liability under the terms of the contract. See infra part III.

26. 42 U.S.C. sec. 9607(a) (1982).

27. Id. at sec. 9601(22).

28. New York v. Shore Realty Corp., 759 F.2d 1032, 1045 (2d Cir. 1985).

29. Id. at 1045.

30. CERCLA defines "hazardous substance" by reference to other environmental statutes. 42 U.S.C. sec. 101(14) (1982). Generally, the term refers to wastes which may cause an increase in mortality or threaten human health or the environment when improperly treated, stored, transported, or disposed. See, e.g., 42 U.S.C. sec. 6903(5) (1982).

31. The national contingency plan is a plan published by the President pursuant to CERCLA section 105 which establishes procedures and standards for responding to releases of hazardous substances, pollutants, and contaminants. 42 U.S.C. sec. 9605 (1982 & Supp. IV 1986).

32. 42 U.S.C. sec. 9607(a)(4) (1982 & Supp. IV 1986).

33. Id. at sec. 9601(25).

34. Id. at sec. 9601(24).



35. Id. at sec. 9601(23).

36. See supra, note 12. This thesis does not address the issue of government/contractor liability for damages to natural resources or health assessment costs. This thesis also does not explore government/contractor tort liability for damages associated with hazardous waste cleanup. CERCLA does not provide for tort liability, but tort liability often exists under state law.

37. Environmental Protection Agency, Federal Facilities Compliance Strategy xii, VI-1, VI-3 (1988). "This respects the position of the Department of Justice that civil suits within the federal establishment lack the constitutionally required justiciable controversy." Id. at VI-3.

38. Id. at xii.

39. 42 U.S.C. sec. 9607(a)(4)(A) (1982 & Supp. IV 1986).

40. 42 U.S.C. sec. 9607(a)(4)(B) (1982 & Supp. IV 1986). See Allied Corp. v. Acme Solvents Reclaiming, Inc., 691 F.Supp. 1100, 1106 (N.D. Ill. 1988).

41. CERCLA section 120 provides that "[e]ach department, agency, and instrumentality of the United States (including the executive, legislative, and judicial branches of government) shall be subject to, and comply with, this chapter in the same manner and to the same extent, both procedurally and substantively, as any nongovernmental entity, including liability under section 9607 of this title." 42 U.S.C. sec. 9620(a)(1) (Supp. IV 1986). See supra notes 7 & 8 and accompanying text.

42. 42 U.S.C. sec. 9601(32) (1982), referring to the Federal Water Pollution Control Act, 33 U.S.C. sec. 1321 (1981).

43. E.g., New York v. Shore Realty Corp., 759 F.2d 1032, 1042 (2d Cir. 1985). See also United States v. N.E. Pharmaceutical and Chem. Co., 579 F.Supp. 823, 843-44 (W.D. Mo. 1984).

44. United States v. Conservation Chem. Co., 619 F.Supp. 162, 204.
45. New York v. Shore Realty Corp., 759 F.2d at 1042.
46. 42 U.S.C. sec. 9607(b) (1982).
47. See supra note 13 and accompanying text.
48. E.g., United States v. Chem-Dyne Corp., 572 F.Supp. 802, 805-10 (S.D.Ohio 1983); United States v. Wade, 577 F.Supp. 1326, 1337-39 (D.Pa. 1983).
49. United States v. A & F Materials Co., Inc., 578 F.Supp. 1249, 1255 (S.D.Ill. 1984).
50. Id. at 1255.
51. Id. at 1255-56.
52. Chem-Dyne Corp., 572 F.Supp. at 811.
53. United States v. Shell Oil Co., 605 F.Supp. 1064, 1083 n.9 (D.Colo. 1985). Accord A & F Materials, 578 F.Supp. at 1256-57.
54. 126 Cong. Rec. S15004 (Nov. 24, 1980)(statement of Sen. Helms) quoted in Chem-Dyne Corp., 572 F.Supp. at 806.
55. A & F Materials, 578 F.Supp. at 1256, cited with approval in Idaho v. Bunker Hill Co., 635 F.Supp. 665, 677 (D.Idaho 1986).
56. 126 Cong. Rec. H9461 (1980), cited in A & F Materials, 578 F.Supp. at 1256.
57. 42 U.S.C. sec. 9613(f) (Supp. IV 1986).
58. E.g., United States v. New Castle County, 642 F.Supp. 1258, 1265 (D.Del. 1986).
59. 42 U.S.C. sec. 9613(f)(1) (Supp. IV 1986).
60. Id. at sec. 9613(f)(2).

61. Id. at sec. 9613(f)(3).
62. 42 U.S.C. sec. 9607(e) (1982).
63. Id. at sec. 9607(e).
64. Southland Corp. v. Ashland Oil, Inc., 696 F.Supp. 994, 1000 (D.N.J. 1988).
65. See Marden Corp. v. C.G.C. Music, Ltd., 804 F.2d 1454, 1459 (9th Cir. 1986) ("Contractual arrangements apportioning CERCLA liability between private 'responsible parties' are essentially tangential to the enforcement of CERCLA's liability provisions. Such agreements cannot alter or excuse the underlying liability, but can only change who ultimately pays that liability.")
66. See supra part II(E).
67. Fed. Acquisition Reg. 16.301-3 (1 Apr. 1984) [hereinafter FAR].
68. Id.
69. FAR 16.301-1 & 31.201-1.
70. FAR 16.301-1.
71. FAR 31.201-2.
72. FAR 31.201-3(a).
73. FAR 31.201-3(b).
74. FAR 31.201-4.
75. Id.
76. FAR 31.205-7.
77. FAR 31.205-15.
78. FAR 31.205-19.
79. FAR 31.205-24.

80. FAR 31.205-25.

81. See Rohm, Contaminants and Costs: Toxic Waste Concerns for the Contracts Attorney, 10 Reporter 44, 45 (1981) (identifying five different areas common to most toxic tort cases: (1) expenses for upgrading a contractor's facilities to prevent future pollution; (2) costs incurred in cleaning up the alleged pollution; (3) legal fees incurred by the contractor in defense of environmental tort allegations; (4) fines and penalties; and (5) damages).

82. Pollution avoidance costs are "cleanup costs" as defined in this thesis (supra note 12), since remedial actions and response costs under CERCLA include actions that may be necessary in the event of the threat of release of hazardous substances into the environment, to prevent or minimize the release. 42 U.S.C. secs. 9601(24), 9601(25) (1982 & Supp. IV 1986).

83. 42 U.S.C. secs. 9601(23), 9601(24) (1982 & Supp. IV 1986).

84. Rohm, supra note 81, at 45.

85. See supra notes 79, 80 and accompanying text.

86. FAR Part 23.

87. Supra note 73, and accompanying text.

88. See note 77, and accompanying text.

89. See supra note 73 and accompanying text.

90. Rohm, supra note 81, at 45.

91. See supra note 73 and accompanying text.

92. Id.

93. See supra note 73 and accompanying text.

94. Rohm, supra note 81, at 45 n.1.

95. Id.

96. FAR 31.109.
97. Id.
98. Rohm, supra note 81, at 44. See infra part IV(D).
99. See supra part II(E).
100. FAR 15.903.
101. Defense Fed. Acquisition Reg. Supp. 216.101 (1 Apr. 1984) [hereinafter DFARS].
102. See Boyle v. United Technologies Corp., 108 S.Ct. 2510, 2518 (1988) (government contractors held liable for design defects in military equipment "will predictably raise their prices to cover, or to insure against, contingent liability for the Government-ordered designs."); Chem. Waste Management, Inc. v. Armstrong World Indus., Inc., 669 F.Supp. 1285, 1291 (D.Pa. 1987) (owners/operators of hazardous waste disposal facilities will take the contractual shifting of CERCLA liability into account by charging waste generators a higher fee for hazardous waste disposal); Miller, Liability and Relief of Government Contractors for Injuries to Service Members, 104 Mil. L. Rev. 1, 47-48 (1982) (denying government contractors the traditional defense of sovereign immunity would result in their including contingencies in their prices to cover losses from liability).
103. See FAR 31.102 (emphasis added).
104. Atlas Corp. v. United States, No. 281-83C (Cl. Ct. 1988), 50 Fed. Cont. Rep. 852 (BNA) (Nov. 21, 1988).
105. Id.
106. Id.
107. See United States General Accounting Off., Hazardous Waste: Issues Surrounding Insurance Availability 12 (1987) (insurers maintain that fortuity of occurrence and predictability of loss cannot be satisfied when dealing with pollution risks).

108. Supra note 104.

109. For example, in 1988, Avtex Fibers, Inc. announced that they would close their plant in Front Royal, Va., citing foreign competition and costs of correcting environmental problems. The plant is the sole supplier of the rayon fiber used in making rocket nozzles. Although Avtex officials subsequently announced the plant would reopen, citing a new three-year, \$38 million contract with NASA, had the plan remained closed, NASA would have been unable to obtain critical supplies for the U.S. space program. Avtex Agrees to Pay Fines, Cleanup Costs; State to Drop Suit, Allow Plant to Stay Open, 19 Env't Rep. (BNA) No.34, at 1668-69 (Dec. 16, 1988).

110. FAR 28.301.

111. FAR 28.306(a).

112. Id.

113. FAR 28.307 & 28.307-2.

114. FAR 31.205-19.

115. FAR 28.307-2(b).

116. Id.

117. Army Fed. Acquisition Reg. Supp. 28.307-2(b)(91) (1 Dec. 1984).

118. FAR 28.308.

119. Factors the contracting officer must consider in making this determination include: (1) the soundness of the contractor's financial condition, including available lines of credit; (2) the geographic dispersion of assets, so that the potential of a single loss depleting all the assets is unlikely; (3) the history of previous losses, including frequency of occurrence and the financial impact of each loss; (4) the type and magnitude of risk, such as minor coverage for the deductible portion of purchased insurance or major coverage for hazardous risks; and (5) the

contractor's compliance with Federal and State laws and regulations. Id.

120. Id.

121. Id.

122. FAR 28.301.

123. See FAR 52.228-7.

124. The "standard CGL policy" as used in this thesis will refer to the standard policy that the Insurance Services Office promulgates from time to time, reprinted in Alliance of American Insurers, Policy Kit for Students of Insurance 258-63, 277 (1985) [hereinafter Policy Kit].

125. Policy Kit, supra note 124, at 263. See, e.g., Mraz v. Can. Universal Ins. Co., Ltd., 804 F.2d 1325, 1327 (4th Cir. 1986).

126. Policy Kit, supra note 124, at 263.

127. Jackson Township Mun. Util. Auth. v. Hartford Accident & Indem. Co., 186 N.J.Super. 156, 451 A.2d 990, 995 (Law Div. 1982).

128. United States Fidelity & Guar. Co. v. Murray Ohio Mfg. Co., 693 F.Supp 617, 622-23 (M.D.Tenn. 1988)(insurer had no duty to defend the insured in suit seeking hazardous waste cleanup costs since the policy's pollution exclusion clause clearly took the cause of action outside the scope of liability under the policy).

129. Policy Kit, supra note 124, at 263.

130. Compare, e.g., Continental Ins. v. N.E. Pharmaceutical & Chem. Co., 842 F.2d 977, 987 (8th Cir. 1988), cert. denied, 109 S.Ct. 66 (1988); Md. Casualty Co. v. Armco, Inc., 822 F.2d 1348, 1354 (4th Cir. 1987), cert. denied, 108 S.Ct. 703 (1988); Travelers Ins. Co. v. Ross Elec. of Wash., Inc., 685 F.Supp. 742, 745 (W.D.Wash. 1988) (holding that environmental cleanup costs are not damages), with e.g., Port of

Portland v. Water Quality Ins. Syndicate, 796 F.2d 1188, 1193-94 (9th Cir. 1986); New Castle County v. Hartford Accident & Indem. Co., 673 F.Supp 1359, 1365-66 (D.Del. 1987); Fireman's Fund Ins. Co. v. Ex-Cell-O Corp., 662 F.Supp. 71, 75 (E.D.Mich. 1987); United States v. Conservation Chem. Co., 653 F.Supp. 152, 160, 194 (W.D.Mo. 1986); United States Aviax Co. v. Travelers Ins. Co., 125 Mich. App. 579, 336 N.W.2d 838, 843 (App. Ct. 1983); CPS Chem. Co. v. Continental Ins. Co. 222 N.J. Super. 175, 536 A.2d 311, 318 (App. Div. 1988); Broadwell Realty v. Fidelity & Casualty, 218 N.J. Super. 516, 528 A.2d 76, 82 (App. Div. 1987) (holding that environmental cleanup costs are not damages covered by the standard CGL policy).

131. E.g., Md. Casualty Co. v. Armco, Inc., 822 F.2d 1348, 1352-54 (4th Cir. 1987), cert. denied, 108 S.Ct. 703 (1988).

132. E.g., New Castle County v. Hartford Accident & Indem. Co., 673 F.Supp. 1359, 1365-66 (D.Del. 1987).

133. See, e.g., Continental Ins. Co. v. N.E. Pharmaceutical & Chem. Co., 842 F.2d 977, 985 (8th Cir. 1988), cert. denied, 109 S.Ct. 66 (1988) [hereinafter NEPACCO].

134. Id. at 987. This case involved claims by the government against the chemical company insured for recovery of cleanup costs under 42 U.S.C. sec. 9607(a)(4)(A). The NEPACCO court distinguished these claims from the claims of private individuals for personal injury, and property damage under 42 U.S.C. sec. 9607(a)(4)(C).

135. Id. at 985-986.

136. Id. at 987.

137. Id.

138. Id. at 986. See also Md. Casualty Co. v. Armco, Inc., 822 F.2d 1348, 1353 (4th Cir. 1987).

139. See, e.g., New Castle County v. Hartford Accident & Indem. Co., 673 F.Supp. 1359, 1365-66 (D.Del. 1987).



140. United States Aviex Co. v. Travelers Ins. Co.,  
125 Mich. App. 579, 336 N.W.2d 838, 843 (App. Ct.  
1983).
141. Policy Kit, supra note 124, at 263.
142. Id. at 259.
143. 796 F.2d 1188, 1193 (9th Cir. 1986).
144. Id. at 1194.
145. Id.
146. 41 Ohio App. 3d 228 (1987).
147. Id.
148. 804 F.2d 1325, 1329 (4th Cir. 1986).
149. Id.
150. Id.
151. New Castle County v. Hartford Accident & Indem.  
Co., 673 F.Supp. 1359, 1366 (D.Del. 1987).
152. Policy Kit, supra note 124, at 263.
153. Independent Petrochemical Corp. v. Aetna Casualty  
& Surety Co., 654 F.Supp. 1334, 1359 (D.D.C. 1986).
154. Policy Kit, supra note 124, at 263.
155. Id. at 259.
156. City of Carter Lake v. Aetna, 604 F.2d 1052, 1056  
(8th Cir. 1979).
157. Policy Kit, supra note 124, at 259.
158. Waste Management of Carolinas v. Peerless Ins.,  
315 N.C. App. 688, 340 S.E.2d 374, 379 (1986).
159. Township of Gloucester v. Md. Casualty Co., 668  
F.Supp. 394, 401 (D.N.J. 1987).

160. Policy Kit, supra note 124, at 259.
161. See generally United States v. Conservation Chem. Co., 653 F.Supp. 152, 195-197 (W.D.Mo. 1986).
162. See generally Mraz v. Can. Universal Ins. Co., Ltd., 804 F.2d 1325, 1328 (4th Cir. 1986).
163. Id.
164. Id. at 1328.
165. Continental Ins. v. N. E. Pharmaceutical & Chem. Co., 842 F.2d 977, 984 (adopting panel opinion at 811 F.2d 1180, 1189 (8th Cir. 1987)), cert. denied, 109 S.Ct. 66 (1988).
166. Id.
167. Id. at 1190. See also Fireman's Fund Ins. Co. v. Ex-Cell-O Corp., 662 F.Supp. 71, 76 (E.D.Mich. 1987) (citing cases).
168. 613 F.Supp. 1549, 1561 (D.N.J. 1985).
169. See, e.g., Mraz, 804 F.2d at 1328.
170. See, e.g., Continental Ins., 842 F.2d at 984.
171. Annotation, Liability Insurance--Each Accident, 55 A.L.R.2d 1300, 1303 (1957).
172. Id.
173. No. L-29236-80 (N.J.Super. Ct. Aug. 31, 1984)(appeal filed, No. A-20138427) reviewed by United States General Accounting Off., Hazardous Waste: Issues Surrounding Insurance Availability 62-63 (1987).
174. Id.
175. Id.
176. Id.
177. Policy Kit, supra note 124, at 263.

178. See United States v. Conservation Chem. Co., 653 F.Supp. 152, 201-204 (W.D.Mo. 1986) (discussion of insured's and insurer's arguments concerning interpretation of the pollution exclusion clause, citing cases). See generally Note, The Pollution Exclusion Clause Through the Looking Glass, 74 Geo.L.J. 1237 (1986).

179. E.g., New Castle County v. Hartford Accident & Indem. Co., 673 F.Supp. 1359, 1364 (D.Del. 1987); Broadwell Realty v. Fidelity & Casualty, 218 N.J. Super. 516, 528 A.2d 76, 80 (App. Div. 1987); Buckeye Union Ins. Co. v. Liberty Solvents & Chem. Co., Inc., 17 Ohio App. 3d 127, 477 N.E. 2d 1227, 1234 (1984). But see United States Fidelity & Guar. Co. v. Murray Ohio Mfg. Co., 693 F.Supp. 617, 621 (M.D.Tenn. 1988).

180. New Castle County, 673 F.Supp. at 1364.

181. Id. at 1362, citing Webster's Third New International Dictionary, at 2284 (1971).

182. Id. at 1363.

183. See Id. at 1364; Broadwell Realty, 528 A.2d at 85-86.

184. E.g., United States Fidelity & Guar. Co. v. Murray Ohio Mfg. Co., 693 F.Supp. 617, 621 (M.D.Tenn. 1988); Waste Management of Carolinas, Inc. v. Peerless Ins. Co., 315 N.C. 688, 340 S.E.2d 743, 374 (1986).

185. Murray Ohio, 693 F.Supp. at 622.

186. 662 F.Supp. 71, 75-76 (E.D.Mich. 1987).

187. See, e.g., New Castle County, 673 F.Supp. at 1364.

188. See, e.g., Waste Management of Carolinas, 340 S.E.2d at 374.

189. United States General Accounting Off., Hazardous Waste: Issues Surrounding Insurance Availability 63 n.16 (1987) [hereinafter GAO Report].

190. Id.
191. Policy Kit, supra note 124, at 263. See, e.g., United States v. Conservation Chem. Co., 653 F.Supp. 152, 199 (W.D.Mo. 1986).
192. GAO Report, supra note 189, at 68.
193. See, e.g., Township of Gloucester v. Md. Casualty Co., 668 F.Supp. 394, 400 (D.N.J. 1987); Fireman's Fund Ins. Co. v. Ex-Cell-O, 662 F.Supp. 71, 75 (E.D.Mich. 1987); Bankers Trust Co. v. Hartford Accident and Indem. Co., 518 F.Supp. 371, 373 (S.D.N.Y. 1981).
194. 668 F.Supp. at 400.
195. 125 Mich. App. 579, 336 N.W.2d 838, 843 (1983).
196. GAO Report, supra note 189, at 69.
197. Id.
198. Id.
199. Id. at 26.
200. 42 U.S.C. sec. 9607(e) (1982).
201. 31 U.S.C. sec. 1341(a)(1) (1982).
202. E.g., Assumption by Government of Contractor Liability to Third Persons, B-201072, 82-1 CPD 406 (May 2, 1982); 35 Comp. Gen. 85, 87 (1955); Johns-Manville Corp. v. United States, 12 Cl.Ct. 1, 22 (1987) (holding that ADA barred officials of the Federal Government from entering into implied contracts to indemnify asbestos manufacturers for manufacturers' liability to shipyard workers exposed to asbestos while building, converting, or repairing ships for the Government during World War II).
203. See, e.g., Johns-Manville Corp., 12 Cl.Ct. at 25.
204. Id.
205. Id.

206. FAR 28.311-2.
207. FAR 52.228-7.
208. See supra, part IV(A).
209. FAR 52.228-7.
210. Id.
211. Federal Procurement Liability Reform Act: Hearing on H.R. 2378 Before the Subcomm. on Administrative Law and Governmental Relations of the House Comm. on the Judiciary, 100th Cong., 1st Sess. 32 (1987) (statement of Michael Monroney, Vice President, TRW, Inc. on behalf of the Contractor Liability and Indemnification Alliance).
212. 10 U.S.C. sec. 2354(a) (1976).
213. DFARS 235.070.
214. DFARS 252.235-7000 & 252.235-7001.
215. Id.
216. 50 U.S.C. sec. 1431-1435 (1976).
217. 50 U.S.C. sec. 1431 (1976).
218. The statute also provides that nothing in the statute shall be construed to constitute authorization for (a) the use of the cost-plus-a-percentage-of-cost system of contracting; (b) any contract in violation of existing law relating to limitation of profits; (c) the negotiation of purchases of or contracts for property or services required by law to be procured by formal advertising and competitive bidding; (d) the waiver of any bid, payment, performance, or other bond required by law; (e) the amendment of a contract negotiated under section 2304(a)(15) of Title 10 or under section 252(c)(13) of Title 41, to increase the contract price to an amount higher than the lowest rejected bid of any responsible bidder; or (f) the formalization of an informal commitment, unless it is found that at the time the commitment was made it was impracticable to

use normal procurement procedures. 50 U.S.C. sec. 1432 (1976).

219. Exec. Order No. 10789, 23 C.F.R. 8897 (1958); as amended by Exec. Order No. 11051, 27 C.F.R. 9683 (1962); Exec. Order No. 11382 32 C.F.R. 16247 (1967); Exec. Order No. 11610, 36 C.F.R. 13755 (1971); Exec. Order No. 12148, 44 C.F.R. 43239 (1979).

220. See Miller, Liability and Relief of Government Contractors for Injuries to Service Members, 104 Mil. L. Rev. 1, 95 (1984).

221. S. Rep. 2281, 85th Cong., 2d Sess. (1958).

222. Exec. Order No. 10789, 23 C.F.R. 8897 (1958); as amended by Exec. Order No. 11051, 27 C.F.R. 9683 (1962); Exec. Order No. 11382 32 C.F.R. 16247 (1967); Exec. Order No. 11610, 36 C.F.R. 13755 (1971); Exec. Order No. 12148, 44 C.F.R. 43239 (1979).

223. Id.

224. Id.

225. Id.

226. Id.

227. Id.

228. FAR 50.403-1.

229. FAR 50.403-2.

230. Most DoD contracts "facilitate national defense."

231. FAR 50.403-2.

232. See generally Smith, Government Indemnification of Contractors: How Far Can You Go Under Public Law 85-847, 18 Nat. Cont. Mgt. J. 1 (1984).

233. Id. at 9-10.

234. Id. at 10, citing 46 Fed. Reg. 62596, 62597 (Dec. 24, 1981).

235. Federal Procurement Liability Reform Act: Hearing on H.R. 2378 Before the Subcomm. on Administrative Law and Governmental Relations of the House Comm. on the Judiciary, 100th Cong., 1st Sess. 32 (1987) (statement of Eleanor R. Spector, Assistant Secretary of Defense for Procurement).

236. Extraordinary Cont. Relief Rep. Current Materials, p. 5143-49.

237. Federal Procurement Liability Reform Act: Hearing on H.R. 2378 Before the Subcomm. on Administrative Law and Governmental Relations of the House Comm. on the Judiciary, 100th Cong., 1st Sess. 32 (1987) (statement of Eleanor R. Spector, Assistant Secretary of Defense for Procurement).

238. Id.

239. FAR 52.250-1.

240. DFARS 252.235-7000 & 252.235-7001.

241. See supra notes 189, 190 and accompanying text.